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SUBJECT: ESTONIA: LABOR SHORTAGE LOOMS LARGE

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SUMMARY: Estonia's dynamic and rapidly expanding economy is quickly exhausting the ability of the country's small population (1.35 million) to provide labor. The signs of a tight labor market are already present - record low unemployment, rising wages, increased worker turnover and shortages in public and service sectors. Businesses have called for higher immigrant labor quotas, but Estonians are not eager to bring in large amounts of foreign workers. Some foreign firms have stopped expanding operations in the country due to the lack of workers. President Ilves has acknowledged that slowing growth is driven, in part, by labor issues. END SUMMARY

SMALL COUNTRY-SMALL LABOR FORCE

¶1. Since emerging from nearly 50 years of Soviet occupation in 1991, the economy of Estonia has been racing. Annual double digit growth rates have been the norm. Estonia is a country of just 1.35 million people with a working population of 692, 800 according to the Estonian Labor Market Board. The Ministry of Social Affairs cites a 4.8% unemployment rate for the country, and 1.4% in the capital city of Tallinn. Estonia added approximately 40,000 jobs in the past year.

ECONOMIC TRANSITION DRIVES LABOR DEMANDS

¶2. The economy is transitioning rapidly as well. Traditional industries in Estonia are mining (oil shale is a major resource), fishing, agriculture and forestry. Employment in these sectors is declining, while there is high labor demand in service industries such as tourism, hotel and restaurants, construction, security, sales, and medicine. Manufacturing is also a fast growing sector as firms from other EU states, especially Finnish and Swedish concerns, rushed to build facilities in Estonia over the past decade to take advantage of a highly skilled and relatively low wage labor force.

ECONOMY MAY HAVE REACHED ITS LIMITS

¶3. There are increasing signs however, the Estonian economy has reached a limit on the amount of labor that it can provide to keep the red hot economy growing. Estonia already has one of the highest labor participation rates in Europe at 64%, according the Maria Varton, Deputy Secretary General of the Ministry of Economy. Increasingly, younger Estonians are opting to stay in school longer (there are nearly 65, 000 students enrolled in higher education) and

to work and study elsewhere in the EU. According to a study published by Hansapank, Estonia's largest bank, 39% of 18-24 year olds intend to seek employment outside the country. Most frequently cited reasons are higher salaries, better working conditions, a wish to experience life outside Estonia and a better climate. A European Foundation for the Improvement of Living and Working Conditions report published in October says that 7% of the Estonian population plans to leave the country in the next 5 years.

LOW BIRTHS AND IMMIGRATION LIMIT WORKER GROWTH

14. Compounding the labor migration of the young adult workers is Estonia's low birthrate and almost non-existent immigration. Like much of the EU, birthrates are well below population replacement levels. The Ministry of Social Affairs cites the children born per woman rate at 1.3 (2.1 is generally considered the level needed to maintain a steady population). The Estonian national government has expanded measures to stimulate birthrates by paying parents who choose to stay at home their current salary (up to \$1600 a month) for up to 1 year and guaranteeing them the ability to return to their place of employment up to 3 years. According to the Estonian Central Bank's labor market survey, currently 38,000 potential workers say they are out of the market due to family care. Of course, this initiative will take 18-20 years to impact the labor force and in the short term, actually removes labor from the market.

SIGNS OF STRAIN-RISING WAGES AND LABOR TURNOVER

15. Already there are signs of strain on the labor markets. Wages and salaries are rising quickly. The Estonian Statistical Service reported that salaries rose 16.4% from the 3rd quarter of 2005 to the same quarter in 2006. Hourly wages rose even faster, 18.8% in the same period. The average monthly salary now stands at 9531 Estonian Kroons per month (USD\$801) and hourly wages at 54.4 EEK/hr (\$4.58) - more than doubling since 2001. Unemployment rates, already below 5%, are predicted to fall to 3.4% by 2008.

16. The rate of labor turnover is also increasing. Previous surveys showed the average length of time Estonians were employed by the same company was 7 years, much higher than the 5 year European Union average. However, a European Foundation study published in October found that nearly 55% of Estonians plan to change jobs in the next 5 years. The increasing turnover appears to be happening already in both service and manufacturing sectors. The general manager of the Radisson SAS hotel in Tallinn, Johann Aschan, cited a 59% labor turnover at his hotel where 15-20% is his company's target for European properties. At an American Chamber of Commerce (AmCham) conference on labor issues in Tallinn in October, representatives of a number of technology companies said that they cannot hold on to engineers and software technicians who are changing jobs between companies on the average of every 3 months and netting 15% salary increases each time.

BUSINESS CALLS FOR ACTION

17. Over the last several months, expatriate business groups such as AmCham and the Swedish and British Chambers of Commerce have tried to focus GOE attention on the labor shortage issue. These groups estimate that Estonia needs to import 100,000 new workers by 2010 to maintain current growth, but note that only 500 non EU workers-primarily those with high technical skills-are currently allowed in each year. Companies also complain about long and tedious

bureaucratic procedures involved in importing workers from non-EU countries. Some foreign firms have said they have stopped expanding operations in the country due to the lack of workers.

18. The Estonian government has as yet been reticent to address the labor import issue and politicians are very unlikely to go on record on this issue in the run-up to March Parliamentary elections. Popular support for increased immigration is believed to be very weak, particularly given that a primary source of additional labor would likely be Russian-speaking workers from Russia, Ukraine and Belarus. At the AmCham conference, Ministry of Social Affairs (MSA) Secretary General Maarja Mandmaa rejected the call for major changes to the tight labor immigration policies, although she stated that an economic ministry working group was looking at new rules. Mandmaa also highlighted other ways the GOE hopes to deal with the labor shortage issue. Among these are increasing productivity, stemming labor migration, recruiting from new EU members such as Romania and Bulgaria and improving statistical reporting so that there is a clearer picture of the evolving situation. Finally, Mandmaa noted that the government has targeted the long term (defined as more than one year) unemployed to fill in the shortage of low skilled labor. However, the Bank of Estonia reported in late October that this group has decreased by 40,000 and there were virtually no workers left who want a job but are unable to obtain one.

19. Though nearly everyone agrees that the labor shortage is problematic, there are differing opinions on what the effects and solutions will be. In the December issue of the AmCham's Estonian Advantage Magazine government and business leaders were asked about this issue. President Toomas Hendrik acknowledged slowing growth, called "the labor shortage one of the biggest issues we face" and said that wages and productivity would have to rise to keep workers in Estonia. At the same time, he rejected calls for immigration of "cheap Russian labor". Alexander Tsarkov, the managing director of FusionOne a technology

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company opines that he "does not see a bright future for the labor market in Estonia because it is possible that economy will stagnate and that salary levels and a lack of work force will lead businesses to move outside of Estonia to Russia, China, and India." Alternatively, Vartan of the Economic Ministry says that higher labor costs will "transform Estonia into a knowledge society" and work to draw back Estonians who have migrated for better salaries. Finally, Prime Minister Andrus Ansip told Charge (reftel) recently he believes the economy can continue to grow without expanding its labor force "through increases in productivity."

10. Comment: Only time will tell how much of an impact labor issues will have on medium- to long-term economic growth in Estonia. Economic forecasts predict GDP growth will slow next year but will remain significantly higher than the EU average. (Recent predictions indicate about 8% growth in 2007, down from close to 12% in 2006.) Despite efforts by the business community to press the issue, the GOE will likely continue to try and avoid a politically-charged discussion about labor immigration for as long as it can.

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